

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
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Refer Reply To:  
CC:TEGE:EB:EC  
PLR-148635-08

Date:  
April 20, 2009

Taxpayer =  
A =  
X =  
Y =

Dear \_\_\_\_\_ :

This letter is a response to your request, dated November 11, 2008 and submitted by your authorized representative, for a private letter ruling under section 83 of the Internal Revenue Code (Code).

Taxpayer currently has outstanding shares of one class of common stock (the Existing Shares), all of which are owned by Taxpayer's employees (the Employee Shareholders). Existing Shares were originally acquired by paying full book value at the time of purchase. Existing Shares are not subject to a substantial risk of forfeiture or vesting schedule. Existing Shares may not be transferred, sold or exchanged except to Taxpayer at the time of termination. Taxpayer is required to repurchase Existing Shares upon an Employee Shareholder's termination of employment, with a purchase price equal to book value at the time of the repurchase. This purchase price is paid out in installments over A years.

For \_\_\_\_\_ years following termination, Employee Shareholders are prohibited from soliciting business from or providing services for any client for whom they provided services previously. If this prohibition is violated, then any remaining installments of the repurchase price will be based on the Employee Shareholder's original purchase price, rather than the book value at the time of termination.

Taxpayer is planning an initial public offering (IPO) of Taxpayer's common stock. As part of the IPO, Taxpayer will also recapitalize its stock and create two new classes of common stock, Class A and Class B. Holders of Class A and Class B stock will have substantially similar rights, with the exception of certain transfer restrictions imposed on Class B shares, as described below. Class A shares will be issued to new shareholders as part of the IPO, upon exercise of outstanding warrants, and in connection with future incentive plans. Class B shares will be issued to Employee Shareholders taking part in an optional share exchange program (the Share Exchange).

In connection with the IPO, Employee Shareholders will be eligible to participate in the Share Exchange, in which their Existing Shares are exchanged for Class B shares on a one-for-one basis. Employee Shareholders will not be required to perform additional services in connection with the receipt of Class B shares or the removal of the repurchase requirement on the Existing Shares. Employee Shareholders who do not elect to participate in the share exchange will continue to hold Existing Shares following the IPO, and Employee Shareholders who do elect to participate in the Share Exchange will hold only Class B stock after the exchange. Current restrictions, including the repurchase requirement, will remain in place with regards to any Existing Shares not exchanged.

Class B shares will only be acquirable by Employee Shareholders, and will not be transferable. Class B shares will not be subject to the same repurchase requirement as the Existing Shares; instead, they will be converted into transferable Class A shares at a rate of Y% of shares on each anniversary of the IPO for X years, so long as the Employee Shareholder remains employed by Taxpayer on that date. If the Employee Shareholder is no longer employed on any anniversary, then all remaining Class B shares will be converted into Class A shares on the X year anniversary of the IPO. Taxpayer represents that other restrictions imposed on Employee Shareholders participating in the Share Exchange, including the prohibition on soliciting business from or providing services for any client for whom they provided services previously, will be substantially similar to the restrictions in place before the IPO.

Taxpayer represents that the cancellation of the repurchase requirement imposed on the Existing Shares will not be treated as a compensatory event by Taxpayer, and that Taxpayer will not take any deduction for Federal income tax purposes in connection with the Share Exchange or the acquisition, holding or resale by Employee Shareholders of Class A or Class B shares.

Taxpayer is requesting a ruling that the cancellation of the repurchase requirement on the Existing Shares is not a compensatory cancellation of a nonlapse restriction and therefore does not result in recognition of income by the Employee Shareholders under section 83 of the Code.

Under section 83(a), if, in connection with the performance of services, property is transferred to any person other than the person for whom the services are performed, the excess of (1) the fair market value of the property (determined without regard to any restriction other than a nonlapse restriction) at the first time the rights of the person having the beneficial interest in the property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over (2) the amount (if any) paid for the property, shall be included in the gross income of the person who performed the services in the first taxable year in which the rights of the person having the beneficial interest in the property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable.

Section 83(d)(1) provides that, in the case of property subject to a nonlapse restriction that allows the transferee to sell the property only at a price determined under a formula, the price so determined shall be deemed to be the fair market value of the property, unless established to the contrary by the Secretary of Treasury.

Under section 83(d)(2), if, in the case of property subject to a nonlapse restriction, the restriction is cancelled, then, unless the taxpayer establishes (A) that the cancellation was not compensatory and (B) that the person, if any, who would be allowed a deduction if the cancellation were treated as compensatory will treat the transaction as not compensatory, the excess of the fair market value of the property (computed without regard to the restriction) at the time of the cancellation over the sum of (C) the fair market value of the property (computed by taking the restriction into account) immediately before the cancellation and (D) the amount, if any, paid for the cancellation, shall be treated as compensation for the taxable year in which the cancellation occurs.

Section 1.83-5(b)(1) of the Regulations provides that whether there has been a noncompensatory cancellation of a nonlapse restriction under section 83(d)(2) depends upon the particular facts and circumstances. Ordinarily, if an employee is required to perform additional services or the employee's compensation is adjusted to reflect the cancellation, a compensatory purpose for the cancellation may exist. By contrast, where the original purpose for the restriction no longer exists, the facts and circumstances may indicate that the cancellation is noncompensatory. For example, if a so-called "buy-sell" restriction was imposed to limit the ownership of a closely-held corporation's stock and the restriction is cancelled in connection with a public offering of the stock, the cancellation generally would be regarded as noncompensatory.

Based on the forgoing, we rule that the removal of the repurchase requirement attached to the Existing Shares is not a compensatory cancellation of a nonlapse restriction under section 83 of the Code.

Except as specifically ruled on above, no opinion is expressed or implied as to the Federal tax consequences of the transaction described above under any other provision of the Code. This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

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WILLIAM C. SCHMIDT  
Senior Counsel  
Executive compensation Branch  
Office of Division Counsel/Associate  
Chief Counsel (Tax Exempt and Government  
Entities)